

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE PRATER CREEK)	
WATER DISTRICT: (1) FOR APPROVAL OF)	
ITS INITIAL CONSTRUCTION PROJECT; (2))	
APPROVAL OF PROJECT FINANCING, AND)	CASE NO. 9369
(3) APPROVAL OF INITIAL WATER SERVICE)	
RATES AND CHARGES)	

O R D E R

Prater Creek Water District ("Prater Creek"), a new water utility, by application filed June 20, 1985, and since revised, is seeking authorization to construct a \$1,053,000 waterworks project, approval of its financing for the project, and service rates. The project financing includes a grant of \$688,000 from the Farmers Home Administration ("FmHA"), a loan of \$323,000 from the FmHA and \$42,000 from applicants for service. The FmHA loan will be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 7 1/8 percent per annum.

The proposed construction will provide initial water service to about 322 applicants for service. Plans and specifications for the construction prepared by Parrott, Ely and Hurt, Lexington, Kentucky, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

A hearing was held in the offices of the Public Service Commission, Frankfort, Kentucky, on August 20, 1986. There were no intervenors and no protests were entered.

COMMENTARY

The Commission is concerned that Prater Creek's estimates of operating expenses are relatively high when compared to similar water utilities, particularly since projected operating expenses need not take into account the expenses that may be expected in future years (i.e. - plant maintenance expense). The Commission therefore cautions Prater Creek to hold its operating expenses to a minimum. Prater Creek is a non-profit water utility, which after completion of construction will provide water service to approximately 322 customers near the City of Prestonsburg, in Floyd County.

There are four other non-profit water utilities currently providing water service in Floyd County: Beaver-Elkhorn Water District, David Water District, Mud Creek Water District and Sandy Valley Water District.

KRS 74.361 states in part:

The general assembly of the Commonwealth of Kentucky determines as a legislative finding of fact that reduction of the number of operating water districts in the Commonwealth will be in the public interest, in that mergers of such districts will tend to eliminate wasteful duplication of costs and efforts, result in a sounder and more businesslike degree of management, and ultimately result in greater economics, less cost, and a higher degree of service to the general public; and that the public policy favors the merger of water districts wherever feasible.

In view of the legislative mandate, the Commission is of the opinion that Prater Creek should seriously consider merging with the other non-profit water systems in Floyd County.

TEST PERIOD

Estimated pro forma expenses have been utilized for the determination of revenue requirements, since there is as yet no historical test year experience for this new utility.

PROJECTED REVENUES AND EXPENSES

Prater Creek projected operating expenses for approximately 280 customers. The Commission accepts them as apparently proper with the following exceptions:

Operating Revenues

Prater Creek estimated operating revenues for the first year at \$85,788, based upon 279 customers with an estimated monthly usage of 4,000 gallons, and 1 large customer with an estimated monthly usage of 30,000 gallons, all at the revised rates proposed in this proceeding. Since testimony at the hearing established that Prater Creek has now received 322 applications for service,¹ proposed operating revenues have been adjusted upward by \$8,664 to reflect the 42 additional customers.

Purchased Water

Prater Creek projected test period purchased water expense of \$21,350 based upon the same 280 applicants. This has been increased by \$3,693 to reflect the 42 additional customers.

Depreciation Expense

Prater Creek included in its projected test period operating expenses depreciation reserve payments of \$2,520. The Uniform System of Accounts does not allow inclusion of reserve fund

¹ Transcript of Evidence ("T.E."), August 20, 1986, page 27.

payments as operating expenses. In response to the Commission's information requests Prater Creek provided a proposed depreciation schedule,² but omitted proper construction overheads. Reflecting construction overheads, tap-on fees from the 322 applicants and excluding depreciation on contributed property, the Commission has calculated depreciation expense of \$7,268 for rate-making purposes. Therefore, the Commission has increased Prater Creek's projected operating expenses by \$4,748³ to substitute the appropriate depreciation expense for the disallowed depreciation reserve fund.

Reserve Fund and Debt Payment

Prater Creek proposed to include in its test period operating expenses a "reserve fund" payment of \$1,200 and a debt payment of \$24,584. The reserve fund was paid to the Water Resources Assistance Corporation ("WRAC") as a security deposit to be used by WRAC if Prater Creek failed to pay the contracted management expenses. As previously stated "reserve fund payments" and "debt payments" are not considered operating expenses. Thus, operating expenses have been reduced by \$25,784. However, test period interest expense will be included in the computation of net income as a below-the-line expense.

² Item No. 13 filed November 7, 1985, in response to the Commission's Order dated October 21, 1985.

³ \$7,268 Depreciation Expense - \$2,520 Depreciation Reserve = \$4,748.

After consideration of the aforementioned adjustments, projected revenues and expenses are as follows:

	Prater Creek's Proposed Operation	Commission Adjustments	Commission Adjusted
Operating Revenues	\$85,788	\$ 8,664	\$94,452
Operating Expenses	81,087	<17,342>	63,745
Operating Income	<u>\$ 4,701</u>	<u>\$26,006</u>	<u>\$30,707</u>

REVENUE REQUIREMENTS

Prater Creek's annual debt service on the debt proposed in this proceeding is \$24,832.⁴ Prater Creek's adjusted net operating income of \$30,707 provides a debt service coverage of 1.24X. Since this is a new system the Commission will allow rates sufficient to generate the level of operating revenues proposed, but will monitor Prater Creek's financial condition through review of its annual reports to determine what, if any, future rate adjustments might be necessary.

RATE DESIGN

Prater Creek proposed a two step rate design with rates of \$13.00 for the first 2,000 gallons (minimum charge), and \$5.50 per 1,000 gallons for all over that amount. These rates were based on estimates of annual usage of 3,360 bills and 13,512,000 gallons. The Commission has adjusted the rate to \$5.00 per 1,000 gallons for an estimated usage of 15,768,000 gallons and 3,864 bills, in accordance with the 322 customers (instead of 280) disclosed at the hearing.

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	Amount	Amortization Factor	Annual Debt Service
Proposed Bonds 7 1/8%	\$323,000	0.07688	\$24,832

Prater Creek has proposed a rate of \$1.40 per 1,000 gallons for emergency service to Mud Creek Water District ("Mud Creek"). Prater Creek stated the \$1.40 was justified because \$1.35 is the cost of purchasing 1,000 gallons from Prestonsburg and the additional 5 cents covers electric, meter reading and billing expense. The Commission is concerned that this is insufficient coverage of the cost of providing water to Mud Creek, especially over a long period of time. Therefore, Prater Creek should enter into a written agreement with Mud Creek fully defining all charges to Mud Creek and the schedule by which they are to be met, the nature and circumstances defining emergency services, and the procedure and conditions for any curtailment of such service.

This contract must be reviewed and approved by the Commission and made a part of the tariff.

Prater Creek has proposed and sufficiently justified special charges for residential connection to existing system, meter changes and service investigation. Special charges for recon-nections and disconnections were proposed; however, sufficient delineation has not been provided so these charges cannot be approved. Documentation and description of these charges and the services for which they are made should be presented to this Commission as a tariff filing.

FINDINGS AND ORDERS

The Commission, after consideration of the application and evidence of record and being advised, is of the opinion and finds that:

1. Public convenience and necessity require that the construction proposed in the application and record be performed and that a certificate of public convenience and necessity be granted.

2. The proposed project for the Prater Creek water system includes 322 service connections, about 18.5 miles of 6-, 4- and 3-inch water main, two water storage tanks, two booster pumping stations, and miscellaneous appurtenances. The low bids received for the proposed construction totaled \$710,156 which will require about \$1,053,000 in project funding after allowances are made for fees, contingencies, other indirect costs and additional construction being considered as a result of receiving bids under the final estimate.

3. Prater Creek should obtain approval from the Commission prior to performing any additional construction not expressly certificated by this Order.

4. Any deviations from the construction herein approved which could adversely affect service to any customer should be done only with the prior approval of this Commission.

5. Prater Creek should furnish duly verified documentation of the total costs of this project including the cost of construction and all other capitalized costs (engineering, legal, administrative, etc.) within 60 days of the date that construction is substantially completed. Said construction costs should be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

6. Prater Creek's contract with its Engineer should require the provision of full-time resident inspection under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering to insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

7. Prater Creek should require the Engineer to furnish a copy of the "as-built" drawings and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

8. A 5/8-inch x 3/4-inch meter should be the standard customer service meter for all new customers and should be installed at all points of service unless the customer provides sufficient justification for the installation of a larger meter.

9. The financing plan proposed by Prater Creek is for lawful objects within the corporate purposes of its utility operations, is necessary and appropriate for and consistent with the proper performance of services to the public and will not impair its ability to perform these services and should, therefore, be approved.

10. The financing secured by Prater Creek for this project will be needed to pay for the work herein approved. Prater Creek's financing plan should, therefore, be approved.

11. The rates proposed by Prater Creek should be denied in that they will produce additional revenues in excess of the revenue requirement of \$94,452.

12. The rates and charges in Appendix A are the fair, just and reasonable rates and charges to be charged by Prater Creek and should produce gross metered water revenues of \$94,452.

13. Emergency service to Mud Creek by Prater Creek should be fully defined in contractual form and filed with this Commission as discussed herein.

14. Prater Creek should investigate the feasibility of merging with the other non-profit water utilities in Floyd County. Prater Creek should file a written report on the results of its investigation with the Commission within 90 days of the date of this Order.

IT IS THEREFORE ORDERED that:

1. Prater Creek be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction project as set forth in the drawings and specifications of record herein.

2. Prater Creek's plan of financing consisting of a loan from the FmHA in the amount of \$323,000 with an interest rate of 7 1/8 percent and a 40-year term, a grant from the FmHA in the amount of \$688,000 and \$42,000 from applicants for service be and it hereby is approved.

3. If under new FmHA loan conditions Prater Creek is notified and granted the option of accepting a lower interest rate at the date of closing, Prater Creek shall file with the Commission

the FmHA notification of the lower interest rate and shall provide all correspondence from and to FmHA concerning this notification within 30 days of the closing date.

4. Prater Creek shall file a statement of the interest rate accepted from FmHA within 30 days of the date of closing.

5. If Prater Creek accepts an interest rate different from the rate approved herein, it shall file amended pages to its bond resolution and an amended amortization schedule.

6. If Prater Creek is eligible but does not take advantage of a lower interest rate at the time of closing, it shall fully document why the lower rate was not accepted showing an analysis of the higher costs associated with the loan over its life.

7. Prater Creek shall comply with all matters set out in Findings 3 through 8 and Finding 13 as if the same were individually so ordered.

8. The rates proposed by Prater Creek be and they hereby are denied.

9. The rates and charges in Appendix A be and they hereby are approved for service rendered on and after the date of this Order.

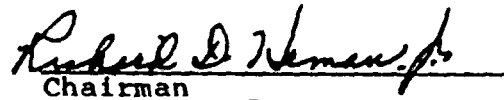
10. Within 30 days from the date of this Order, Prater Creek shall file with the Commission its tariff sheets setting out the rates approved herein.

11. Within 30 days of the date of this Order, Prater Creek shall file a copy of the contract for emergency services provided by it to Mud Creek Water District for the approval of this Commission.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 21st day of October, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9369 DATED 10/21/86

The following rates and charges are prescribed for the customers in the area served by Prater Creek Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Rates: Monthly

First 2,000 Gallons	\$ 13.00 Minimum Bill
Over 2,000 Gallons	5.00 Per 1,000 Gallons
Emergency Service to Mud Creek Water District	1.40 Per 1,000 Gallons

Special Charges

Connection Fee	\$275.00
Meter Changes	13.00

If meter test shows meter to be more than two percent fast, this charge will be refunded.

Service Investigation Charge	\$ 8.00
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This charge will be for service investigations if interruption of service is not caused by failure of District's facilities.